

~~CONFIDENTIAL~~Tab BThe Impact of the Pipeline on Western Europe

Although construction of the proposed pipeline would have a substantial impact on the Soviet economy and military potential, it would have little effect on Western Europe's economies but would make Western Europe somewhat more vulnerable to Soviet political pressure.

Specifically, purchases of Soviet gas through the pipeline:

- Would not be needed to cover increased energy demand;
- Would add to the problem, not to the solution, of energy supply security.
- Would probably be an expensive source of energy.

1. Will the Soviet gas be needed?

(a) Projections of European energy demand are being substantially lowered.

- Between 1978, when the pipeline plans were first seriously discussed, and this year, IEA's projections of West European energy demand in 1990 were lowered by almost 4 million b/d. (See attached table).
- IEA projection of total industrial nation energy demand was lowered by 16 million b/d.
- The amount of Soviet gas to be imported through the proposed pipeline -- .5 to .8 million b/d equivalent is only about one eighth to one fifth as large as the reduction in projected European energy demand.
- This may not be the end of the story; demand projections may continue to be lowered as information on the strength of market reactions to higher oil prices pours in.

(b) Many projections of European demand for natural gas also are being lowered.

- During the past 2 years, [REDACTED] have lowered their 1990 forecasts by about the volume of the projected Soviet deliveries.

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(c) Alternative energy sources are available;

- Recent and likely future U.S. withdrawals from LNG deals with Algeria and Nigeria will make available more LNG from these sources to Western Europe than is now projected in European plans. Indeed, Western Europe is the only alternative market for this gas. The amount of additional gas made available to Europe is about 2.3 billion cubic feet per day, or 50-75 percent of the additional Soviet gas. US needs can be met from domestic, Canadian, and Mexican sources.
- After 1990, more than enough Norwegian gas can be developed to offset the Soviet gas. A single gas structure, discovered and explored during the past 3 years, could produce at least two-thirds of the proposed Soviet deliveries by the early to mid-1990s.
- US coal supply will be ample to meet increases in European coal demand substantially larger than now planned. The necessary adjustments in European energy policies would not be particularly difficult. European investments in US coal infrastructure--for example, in building a large port capable of handling very large coal carriers--would make the coal cheaper. Loss of Soviet gas could be offset by some 40-60 million tons of coal imports, an increase of about one-third in current projections of West European coal imports.

2. Would the pipeline enhance or weaken European energy security?

- (a) The European argument that the pipeline would increase the security of energy supply by diversifying sources and reducing dependence on the insecure Persian Gulf is weak, if not totally invalid.
 - Even if Soviet gas supplies were secure, they would not provide insurance against the contingencies of interruptions of Persian Gulf oil, because--
 - (1) Soviet gas would substitute for only a small part (less than 10 percent) of Persian Gulf supplies and;
 - (2) The supply of Soviet gas could not be expanded if the Persian Gulf or other foreign supplies were interrupted.

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(b) Supplies of Soviet gas are themselves not reliable; they are subject to both technical and political risks.

-- The technical risks result from severe climatic conditions in the USSR and the near absence of spare Soviet pipeline capacity and gas storage; periodically the Soviets make large cuts in their exports to Western Europe to meet priority domestic needs (this point is well known to the Europeans).

-- Although in most likely circumstances Moscow would be loath to use its gas as a blunt weapon to pressure Western Europe, because it needs the gas revenue badly, it would be able to exert subtle political pressure.

-- Vulnerability to Soviet pressure would increase despite the fact that increases in imports of Soviet gas would about offset declines in imports of Soviet oil. For most of Western Europe, Soviet oil is a marginal and variable source of energy, for which alternatives can be quickly found. Soviet gas, however, would become part of the base load of European energy supply because of the high investment costs required.

(c) Although other sources of gas too are subject to technical and political risks, in a number of cases, these risks will probably decline;

-- Specifically, Algeria and Nigeria both will become highly dependent on a steady flow of gas revenues to cover their expenditures.

3. Is Soviet gas a source of cheap energy?

(a) Soviet gas, if priced at approximate parity with crude oil, is not cheap. US and Australian coal are substantially cheaper.

(b) If, [REDACTED] oil markets continue to be soft for several years, the bargaining position of gas importers will become stronger and stronger. Consequently, patient buyers are likely to get better terms.

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